

# GENERAL FUND/FEDERAL FUNDS UPDATE 2005 BIENNIUM PROJECTED

A Report Prepared for the  
**Legislative Finance Committee**

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## **INTRODUCTION**

The purpose of this report is to provide the committee with information on significant general fund revenue trends that are occurring in fiscal 2004 and to provide an outlook for the remainder of the 2005 biennium. The 2005 biennium outlook shows the projected ending fund balance when the federal Jobs and Growth Tax Relief Reconciliation Act monies are included.

At the committee meeting in December, our office expressed concerns over some of the revenue trends that were developing based on data through the end of November 2003. This report is based on information received through the end of February 2004.

The report is organized in three relevant sections. The first section discusses the 2005 biennium general fund outlook including a detailed discussion of the major general fund revenue sources. Significant disbursement issues impacting the 2005 biennium are also discussed. The second section addresses the potential for statutorily required reductions in spending per Title 17-7-140, MCA. The third section provides a summarization based on information received so far this biennium.

## **2005 BIENNIUM GENERAL FUND OUTLOOK**

### **FISCAL 2004 REVENUE TRENDS**

Based on information recorded through the end of February 2004 on the Statewide Accounting, Budgeting, and Human Resource System (SABHRS), total general fund receipts for fiscal 2004 were \$747.5 million as shown in Table 1. This compares to \$685.1 million collected for the same period of fiscal 2003. Total general fund collections are \$62.4 million above last year's amount, which represents a 9.1 percent increase.

<p align="center"><b>Table 1</b> <b>General Fund Receipts By Revenue Category For Fiscal 2004</b></p>						
Revenue Category	Estimated 2004 Receipts *	Through 2/28/03 Receipts	Through 2/29/04 Receipts	Over(Under) Change	Percent Change	HJR2 Est. % Change
GF0100 Drivers License Fee	\$2,850,000	\$1,553,979	\$1,649,919	\$95,941	6.17%	34.47%
GF0200 Insurance Tax	56,038,000	20,900,707	21,784,052	883,345	4.23%	10.29%
GF0300 Investment Licenses	4,618,000	4,472,039	4,005,021	(467,018)	-10.44%	-10.18%
GF0400 Vehicle License Fee	79,774,000	42,454,306	42,669,221	214,914	0.51%	6.10%
GF0500 Vehicle Registration Fee	31,762,000	15,496,609	14,941,216	(555,393)	-3.58%	12.03%
GF0600 Nursing Facilities Fee	5,704,000	2,915,231	2,966,655	51,424	1.76%	-2.66%
GF0700 Beer Tax	3,058,000	1,649,817	1,718,782	68,966	4.18%	10.34%
GF0800 Cigarette Tax	34,993,000	4,793,437	23,190,930	18,397,493	383.81%	178.25%
GF0900 Coal Severance Tax	8,384,000	5,270,600	4,825,298	(445,302)	-8.45%	-13.76%
GF1000 Corporation Tax	64,762,000	24,110,046	35,584,885	11,474,839	47.59%	46.73%
GF1100 Electrical Energy Tax	4,408,000	2,062,616	2,174,876	112,261	5.44%	6.73%
GF1150 Wholesale Energy Trans Tax	3,432,000	1,665,688	1,495,886	(169,802)	-10.19%	-2.83%
GF1200 Railroad Car Tax	1,688,000	962,926	1,084,740	121,815	12.65%	13.73%
GF1300 Individual Income Tax	558,059,000	338,773,741	353,865,156	15,091,416	4.45%	4.15%
GF1400 Inheritance Tax	7,516,000	8,259,263	9,285,635	1,026,373	12.43%	-43.51%
GF1500 Metal Mines Tax	2,967,000	-	-	-	0.00%	-35.31%
GF1700 Oil Severance Tax	26,932,000	4,076,589	10,558,194	6,481,605	159.00%	-7.41%
GF1800 Public Contractor's Tax	3,354,000	2,732,732	1,577,217	(1,155,516)	-42.28%	8.84%
GF1850 Rental Car Sales Tax	2,180,000	-	1,439,217	1,439,217	0.00%	
GFxx00 Property Tax Levy	174,311,000	93,320,654	96,346,150	3,025,496	1.74%	1.53%
GF2150 Lodging Facilities Sales Tax	8,807,000	-	4,944,258	4,944,258	0.00%	
GF2200 Telephone Tax	-	33,498	16,080	(17,418)	-52.00%	-100.00%
GF2250 Retail Telecom Excise Tax	21,190,000	8,446,252	8,448,724	2,471	0.03%	1.85%
GF2300 Tobacco Tax	3,174,000	1,310,106	2,091,830	781,724	59.67%	37.73%
GF2400 Video Gaming Tax	45,012,000	22,397,915	24,499,349	2,101,433	9.38%	-1.71%
GF2500 Wine Tax	1,283,000	833,226	867,844	34,617	4.15%	-4.24%
GF2600 Institution Reimbursements	16,757,000	8,031,391	8,739,675	708,283	8.82%	28.48%
GF2650 Highway Patrol Fines	4,697,000	2,459,221	2,335,235	(123,987)	-5.04%	14.29%
GF2700 TCA Interest Earnings	14,060,000	4,147,462	3,761,234	(386,228)	-9.31%	120.85%
GF2800 Local Impact Interest	-	-	-	-	0.00%	
GF2900 Liquor Excise Tax	10,239,000	6,106,168	6,393,178	287,011	4.70%	1.96%
GF3000 Liquor Profits	5,400,000	-	-	-	0.00%	-10.00%
GF3100 Coal Trust Interest Earnings	37,187,000	18,436,518	17,166,964	(1,269,554)	-6.89%	2.45%
GF3300 Lottery Profits	5,595,000	1,457,734	1,954,747	497,013	34.09%	-24.93%
GF3450 Tobacco Settlement	3,105,000	5,451,945	29,482	(5,422,463)	-99.46%	-83.40%
GF3500 U.S. Mineral Leasing	23,469,000	11,864,059	15,687,350	3,823,291	32.23%	-9.70%
GF3600 Other Revenue	<u>34,074,000</u>	<u>18,674,517</u>	<u>19,435,489</u>	<u>760,972</u>	<u>4.07%</u>	<u>-22.81%</u>
Total Revenue	\$1,310,839,000	\$685,120,992	\$747,534,489	\$62,413,498	9.11%	5.17%
* House Joint Resolution 2 estimates as adjusted for enacted legislation.						

This trend by itself indicates that general fund revenue growth may be above expectations since total revenues were expected to increase by 5.2 percent from actual fiscal 2003 collections to fiscal 2004 estimates. If the growth rate drops below 5.2 percent, the revenue estimate contained in House Joint Resolution 2 (HJR 2) will not be achieved. Estimated collections for fiscal 2004 are from HJR 2 adjusted for impacts of legislation enacted during the 58<sup>th</sup> Legislature.

While the growth rate of 9.1 percent is above the adjusted HJR 2 estimated rate of 5.2 percent, there are unusual events occurring between fiscal years that make this comparison misleading. For example, cigarette tax, lodging facilities sales tax, and rental car sales tax are not comparable to last year because of legislation enacted by the 58<sup>th</sup> Legislature. If these categories are adjusted for comparability, then total receipts would be above last year by about 5.5 percent, considerably below the 9.1 percent shown in Table 1.

## DISCUSSION OF SELECTED REVENUE SOURCES FOR THE 2005 BIENNIUM

As explained in the previous section of the report, a comparison of total revenues from the previous fiscal year to the current fiscal year can be misleading. Not only can statutory modifications change revenue trends, but change in general economic conditions can also skew aggregate growth trends.

During fiscal 2004, several economic assumptions adopted by the 58<sup>th</sup> Legislature have not improved as anticipated. Although the revenues associated with these economic assumptions are below forecasts, collections in the later part of the year will probably not rebound even if economic conditions improve. This is due to the time lag between the economic changes and when the impacted tax revenues are actually received.

The following section of the report addresses selected revenue sources whose collections in fiscal 2004 are anticipated to be significantly different than estimated by the 58<sup>th</sup> Legislature. Table 2 shows these twenty-two sources of revenue and the revenue estimate adjustments for the 2005 biennium. The adjustments portrayed are based on economic and accounting information received through February 2004.

### Corporation Tax - (\$47.3 million)

Corporation tax collections through February 2004 are higher than the comparable period of 2003. However, there is an expectation of a significant downturn in corporate income tax resulting from the impact of the recession that occurred in 2001. Three factors that explain the significant change in revenue are increased refunds, increased and extended bonus depreciation, and audit activity.

Corporate refunds are well above the expected level, and there is a further expectation that several significant refunds will be made during both fiscal 2004 and 2005. The 2003 Jobs and Growth Tax Relief Reconciliation Act increased the bonus depreciation provision, implemented in the 2002 economic stimulus plan, from 30 percent to 50 percent and extended it an additional year, resulting in an additional reduction of expected corporation tax liabilities. One unusually large audit increased the projections for audit income in fiscal 2004.

It should be noted that corporation tax records are confidential per Title 15-31-511, MCA. Because of this section of the law, the Legislative Fiscal Division can not divulge the specifics of any return, refund or audit activity. This statute reads in part:

**15-31-511. Confidentiality of tax records.** (1) Except as provided in this section in accordance with a proper judicial order or as otherwise provided by law, it is unlawful to divulge or make known in any manner:

(a) the amount of income or any particulars set forth or disclosed in any return or report required under this chapter or any other information relating to taxation secured in the administration of this chapter; or

Table 2 Revenue Estimate Adjustments In Millions	
Source of Revenue	2005 Biennium
Corporation Tax	(47.263)
TCA Interest Earnings	(18.724)
Property Tax Levy	(9.212)
Other Revenue	(7.689)
Insurance Tax	(6.327)
Vehicle Registration Fee	(3.097)
Coal Trust Interest Earnings	(2.528)
Institution Reimbursements	(2.176)
Highway Patrol Fines	(1.228)
Public Contractor's Tax	(0.919)
Retail Telecom Excise Tax	(0.883)
Coal Severance Tax	(0.319)
Wholesale Energy Tax	(0.170)
Rental Car Sales Tax	0.814
Lottery Profits	1.423
Cigarette Tax	1.439
Vehicle License Fee	3.878
Inheritance Tax	4.626
Video Gaming Tax	7.312
US Mineral Royalties	9.665
Oil & Gas Production Tax	9.862
Individual Income Tax	26.113
Total	(\$35.403)

*(b) any federal return or information in or disclosed on a federal return or report required by law or rule of the department of revenue under this chapter.*

### **TCA Interest Earnings - (\$18.7 million)**

Treasury cash account interest revenue is based on the amount of cash available to invest and the prevailing short-term interest rates. Both factors have declined. Cash balances in the account have decreased, necessitating the need to borrow more money for cash flow purposes than anticipated. In addition, the federal discount interest rate has plummeted from 6.0 percent in December 2001 to 0.75 percent in December 2002. Data from the Board of Investments show the yield on the treasury cash account for fiscal 2003 was 2.3 percent. The yield to date for fiscal 2004 is also about 2.3 percent. This compares to the HJR 2 short-term interest rate assumption of 4.7 percent.

### **Property Tax Levy - (\$9.2 million)**

Property tax revenues were \$1.4 million above the estimate in fiscal 2003. This was due to higher than anticipated oil and natural gas prices during the first half of fiscal 2003. Before January 1, 2003, oil and natural gas revenues were distributed to the state based on the ratio of state mills to total mills. HB 748 requires that these revenues now be distributed directly to the state general fund.

The current forecast of property tax revenues is \$9.2 million below the adjusted HJR 2 forecast. The legislation-adjusted HJR 2 estimates for the 2005 biennium include the impact of SB 294, which requires that the state's share of taxes protested by the Pennsylvania and Power and Light Company from prior years and the current year be removed from an escrow account and deposited in the general fund. This was expected to be \$8.5 million in fiscal 2004. However, in fiscal 2003, \$3.8 million of the protested taxes were deposited in the general fund, thus reducing the amount available for deposit in fiscal 2004 by \$3.8 million. The remaining \$5.4 million reduction in property taxes reflects a smaller than anticipated tax base in tax year 2003, and slightly smaller growth rates for taxable value than were in HJR 2. The smaller than anticipated tax base in tax year 2003 is the result of no growth in class 8 business equipment and a sharp reduction in telecommunications property value, presumably due to the bankruptcy of a major Montana telecommunications company. The adjusted HJR 2 estimate and the current estimate both reflect the impacts of SB 461, the bill that phased in the new reappraisal values, tax rates and exemptions for commercial and residential property.

### **Other Revenue - (\$7.7 million)**

Changes to all other revenue are the result of unanticipated one-time increases and decreases in major revenue sources. Increases include \$750,000 more in security fraud settlements, a \$450,000 premium resulting from the sale of \$73.4 million in tax revenue anticipation notes, and \$815,173 from the sale of the Bozeman Armory. House Bill 363 directed that \$8.1 million of excess funds be transferred from the old state fund to the general fund in the 2005 biennium. State Fund officials estimate that only \$815,000 will be available for transfer, a reduction of \$7.3 million. Although the legislature anticipated that the State Auditor would increase portfolio filing fees, the fees have not been increased resulting in a loss of \$2.0 million.

### **Insurance Tax - (\$6.3 million)**

Insurance premiums tax is levied on the net premiums or gross underwriting profit for each insurance company operating in Montana. The premium growth assumptions adopted in HJR 2 were based on unusually high rates. Since insurance companies were experiencing reduced investment income due to the weak equity markets, premium rates were expected to increase significantly to compensate for the lower investment income.

Beginning in late fiscal 2003, a slowdown in premium growth was detected. These lower growth rates have continued into fiscal 2004 and are not expected to change materially in fiscal 2005. Total general fund revenues for the 2005 biennium are expected to be below adjusted HJR 2 estimates by \$6.3 million for the 2005 biennium.

### **Vehicle Registration Fee - (\$3.1 million)**

Revenue from vehicle registration fees was \$0.6 million above estimate in fiscal 2003. More cars registered were the likely reason. The current forecast of vehicle registration fee revenue for the 2005 biennium is below the adjusted HJR 2 amount by \$3.1 million. This is primarily due to a slower expected growth rate and new information about SB 336. The executive has indicated that the revenue from SB 336 (a bill that instituted a new optional \$4 fee on each light vehicle to be used to pay for operations at state parks, fishing access sites, Virginia City and Nevada City beginning January 1, 2004) will be deposited in a state special revenue account, not the general fund as the bill specifically states. The bill is expected to generate \$3.2 million during the 2005 biennium.

### **Coal Trust Interest Earnings - (\$2.5 million)**

Coal trust interest earnings are generated from the investment of the coal severance tax trust fund. By statute, investment earnings not earmarked to other programs are deposited to the general fund. While fiscal 2004 earnings were anticipated to increase from fiscal 2003, the collections for the first eight months of fiscal 2004 are \$1.3 million behind the comparable period of fiscal 2003. After adjusting for an accounting error made in October and other accounting differences between fiscal years, the shortfall for the 2005 biennium is expected to be \$2.5 million. Lower interest earnings from investments in the short-term investment pool are the main reason for the reduction.

### **Institution Reimbursements - (\$2.2 million)**

Adjustments in numerous assumptions have led to a change in anticipated revenue collections during the 2005 biennium for institution reimbursements. Most of the change is captured in revisions to three major assumptions including the Federal Medicaid Assistance Percentage (FMAP) rates, Medicaid eligibility, debt service expenses, and the fiscal impact of the judicial decision in the Travis D. lawsuit.

Changes in the expected FMAP rates were made in the Federal Jobs and Growth Tax Relief Reconciliation Act of 2003. The FMAP rate increases were instituted beginning in April 2003. As a result, the increased rates applied to the end of fiscal 2003 and through the third quarter of fiscal 2004. The effective annual FMAP rate for fiscal 2004 is 75.15 percent, or 2.18 percentage points greater than initially assumed. In fiscal 2005, the FMAP rate is now expected to be less than the HJR 2 assumption. The fiscal 2005 FMAP assumption of 72.81 percent has been revised to 72.29 percent, a reduction of 0.52 percentage points.

The state was informed last spring that 19 individuals at the Montana Developmental Center (MDC) in Boulder were being decertified as Medicaid eligible. This will result in the loss of reimbursements deposited to the general fund of about \$2.0 million annually. Formal notification of decertification has not yet occurred. Thus, loss of Medicaid reimbursement for these individuals has not yet occurred. The potential impact of this issue has not been incorporated into the revenue adjustments.

The Travis D. vs. State of Montana lawsuit was settled in favor of the plaintiff, requiring the state to move specified residents, those with the ability to function in a community setting, from MDC. As a result, the state plans to reduce occupancy at the hospital by approximately 26 residents by the end of fiscal 2005. This reduction in residency is expected to reduce public institution reimbursements by

almost \$2.0 million in fiscal 2005. For more information on this issue, please refer to the March 2004 report by Pat Gervais, "Developmental Disabilities Program: Emerging Issues and Status of Eastmont."

The bond issued for the MDC project was refinanced during fiscal 2003 creating a debt service savings of \$247,055 for the 2005 biennium.

Combined, these changes are expected to increase institution reimbursements by \$1.6 million in fiscal 2004 and reduce reimbursements by \$3.8 million in fiscal 2005.

### **Highway Patrol Fines - (\$1.2 million)**

Reduced issuance of citations has lowered fine revenue in fiscal 2004, and the level of citations issued is expected to remain lower than assumed in HJR 2, causing a reduction to the estimate for the 2005 biennium of \$1.2 million. The Highway Patrol Division is operating this biennium with fewer officers than in the past. Currently, the patrol has 14 vacant positions. Of those, seven positions are staffed with officers stationed with the National Guard in Iraq. Those positions are expected to remain vacant until August 2004, at which time the seven officers will return to duty and three other officers will take National Guard leave. Another seven positions will remain vacant to achieve vacancy savings assessed by the 58<sup>th</sup> Legislature. The number of citations issued in July and January was approximately 20 percent lower than the same period last year. Fines are expected to be \$0.7 million lower than the adjusted HJR 2 estimate in fiscal 2004 and \$0.5 million lower in fiscal 2005.

### **Public Contractors Gross Receipts Tax – (\$0.9 million)**

Public contractors gross receipts tax collections are \$1.2 million below collections of the same period in fiscal 2003, and revenues are expected to be lower than the HJR 2 estimates by \$0.9 million in fiscal 2004. Two reasons explain the difference from the estimate. First, two unusually large corporation tax credits, amounting to over \$800,000, were processed in January. Next, the Department of Revenue has been running behind on the processing of credits and refunds. Individual and corporation credits from prior years are being processed this fiscal year, resulting in reduced net tax revenues. These events are not expected to have an impact on fiscal 2005 revenues.

### **Retail Telecommunication Excise Tax - (\$0.9 million)**

In 2003, revenue from the telecommunications tax was bolstered by over \$543,000 in audit collections. Removing this amount from 2003 collections and applying the rate of growth already observed in fiscal 2004 through February (3.23 percent), results in a forecast of telecommunications revenue of \$20.9 million for fiscal 2004. This is below the HJR 2 estimate of \$21.2 million by \$0.3 million for fiscal 2004. Using the growth rate of 3.2 percent for fiscal 2005 results in an additional reduction of \$0.6 million relative to the HJR 2 estimate.

### **Coal Severance Tax - (\$0.3 million)**

The coal severance tax is levied on each company's coal production in excess of 20,000 tons each year. Coal severance tax collections are expected to be below the adjusted HJR 2 forecasts by \$319,000 for the 2005 biennium. The main reason for this decline is lower production amounts anticipated by one of the major coal producers in the state.

**Wholesale Energy Transaction Tax – (\$0.2 million)**

The revenue estimate for the wholesale energy transaction tax in fiscal 2004 is reduced by \$0.2 million due to an unanticipated refund for overpayments by one of the electrical companies in the fall of 2003. This one-time event reduces collections for fiscal 2004, but not fiscal 2005.

**Rental Car Sales Tax – \$0.8 million**

With only two quarters of collections received for this new tax that began July 2003, adjustments for seasonal variations show an increase of \$400,000 each year of the biennium.

**Lottery Profits - \$1.4 million**

All gross lottery revenue not used for prizes, commissions, and operating expenses is considered net revenue. Total net revenue (including interest earned on the proprietary account) is transferred to the general fund. For the past two fiscal years, annual lottery revenue transfers to the general fund have exceeded \$7.4 million.

According to the lottery director, the fiscal 2003 transfer of \$7.5 million was somewhat unusual because of unique events that are not anticipated in the future. Fiscal 2004 and 2005 revised collections are expected to be slightly less at \$7.0 million per year. The introduction of several new games beginning calendar 2004 is expected to bolster net revenue transfers by about \$1.4 million for the 2005 biennium.

**Cigarette Tax - \$1.4 million**

The tax on cigarettes is expected to generate \$1.4 million more than the adjusted HJR 2 estimates in the 2005 biennium. Revenues through February are \$18.4 million above collections in fiscal 2003. Most of this increase is due to the increased tax rate. However, consumption has not dropped off as much as predicted. As a result, fiscal 2004 revenues are expected to be \$0.8 million greater than the estimate of HJR 2 and fiscal 2005 revenues \$0.6 million greater.

**Vehicle License Fee - \$3.9 million**

Revenue from vehicle taxes was \$0.4 million above the estimate for fiscal 2003. Likely, some of this increase was due to dealer incentives increasing the purchase of new cars. The current forecast of vehicle tax revenue for the 2005 biennium exceeds the adjusted HJR 2 amount by \$3.9 million. This reflects a higher fiscal 2003 starting base, and a higher growth rate of 1.6 percent per year when compared with the growth rates in HJR 2. The forecast includes a \$7.9 million biennial impact of HB 559, which allows for a one-time lifetime flat fee on watercraft, snowmobiles, motorcycles, quadricycles, and trailers, effective January 1, 2004.

**Inheritance Tax - \$4.6 million**

Inheritance tax collections continue to be strong following the unpredictably high collections of fiscal 2003. While HJR 2 anticipated reduced collections as the federal estate tax is eliminated, revenues in fiscal 2004 are actually greater than revenues collected in the same period of fiscal 2003. Analysis of inheritance tax collections show that in fiscal 2004, normal collections have fallen off substantially, yet five large estates with tax liabilities in excess of \$0.8 million have been settled. Two of those estates had tax liabilities of over \$1.0 million. As a result, inheritance tax collections are expected to be greater than the HJR 2 estimates by \$4.6 million in fiscal 2004. No changes are expected in fiscal 2005.



### **Video Gambling Tax - \$7.3 million**

Video gambling revenue is derived from two sources: license fees and video gambling taxes. The fifteen percent tax on gross income less payouts produces the majority of the collections from this source. Based on revenue growth from fiscal 2002 to 2003 and conversations with the Gambling Control Division, Department of Justice, collections for the 2005 biennium are expected to exceed the adjusted HJR 2 estimate by \$7.3 million. The HJR 2 growth assumptions were premised on a peak in machine play with growth abated from historical levels. Current collection trends do not support this assumption.

### **US Mineral Royalty - \$9.7 million**

US mineral royalty collections through February 2004 are \$3.8 million above the comparable period for fiscal 2003. Higher natural resource prices, particularly oil and natural gas, increase the amount of royalties Montana receives from these commodities above HJR 2 estimates by \$1.9 million. Monthly coal royalties have been consistently higher than anticipated resulting in an additional \$7.7 million if this trend continues through the 2005 biennium. It should be noted that HB 226 passed by the 57<sup>th</sup> Legislature transfers 12.5 percent of US mineral royalty revenue deposited to the general fund in fiscal 2004 and 25 percent in fiscal 2005 to the counties where the mining or extraction occurred. Therefore, although higher natural resource prices result in additional general fund revenue, disbursements from the general fund also increase by an estimated \$1.8 million.

### **Oil & Gas Production Tax - \$9.9 million**

Revenue from oil and natural gas production taxes was \$7.4 million above the estimate for fiscal 2003, primarily due to much higher prices for both commodities. Also, special low tax rates for incentive production were increased temporarily in the 2<sup>nd</sup> quarter of fiscal 2003 because the price of West Texas Intermediate (WTI) oil was above \$30 per barrel. Current law requires tax rates on stripper and alternative oil wells be increased during each quarter that WTI is above \$30 per barrel. The current forecasts of oil and natural gas production tax revenues during the 2005 biennium exceed those in HJR 2 by \$9.5 million. This is primarily due to forecasts of higher oil and natural gas prices.

Montana prices for oil and natural gas in fiscal years 2004 and 2005 are expected to be substantially above prices assumed in HJR 2. The HJR 2 prices for the two years of the 2005 biennium were between \$21.00 and \$22.00 per barrel for oil, and between \$2.80 and \$2.90 per MCF (Million Cubic Feet) for natural gas. Currently, the forecasts for oil prices are \$27.00 for fiscal 2004 and \$23.50 for fiscal 2005. The current forecasts for natural gas are \$3.50 in both fiscal 2004 and fiscal 2005. These are prices consistent with forecasts supplied by Global Insights. In addition, current forecast production levels for oil are around 2.2 million barrels above HJR 2 levels. However, current forecast production levels for natural gas are below those in HJR 2 by 16 million MCF in fiscal 2004 and by 18 million MCF in fiscal 2005. This is due to a reduction in the 2003 natural gas production base of around 13 million MCF below the HJR 2 estimate.

### **Individual Income Tax - \$26.1 million**

Income tax receipts for the 2005 biennium are expected to be \$26.1 million above estimates in HJR 2 adjusted for legislation. Gross collections (actual collections plus refunds added back) through February of 2004 were 3.7 percent above gross collections through February 2003. This increase was applied to total year gross collections in fiscal 2003 to derive a forecast of gross collections in fiscal 2004. Gross collections in fiscal 2004 were then adjusted downward by the estimate of refunds in fiscal 2004. This downward adjustment was 23 percent of gross collections, the ratio of refunds to

gross collections observed in fiscal 2002. Refunds in fiscal 2003 appear to have been unusual in that more returns were filed in October 2002 than normal. The fiscal 2004 income tax estimate after refunds was further adjusted by the estimated impacts of legislation passed during the 2003 legislative session and by the impacts of the federal Jobs and Growth Tax Relief Reconciliation Act, enacted in May 2003 (see below).

The new estimate of fiscal 2004 income tax collections was increased by the same growth rate as the HJR 2 estimate to derive a new estimate for fiscal 2005. This estimate was adjusted for legislation enacted by the 58<sup>th</sup> Legislature, plus the impact of the federal Jobs and Growth Tax Relief Reconciliation Act enacted in May 2003.

### ***Impact of Federal Tax Relief on State Income Tax Revenues***

In May of 2003, the federal Jobs and Growth Tax Relief Reconciliation Act of 2003 was signed into law. This act accelerated the phased-in tax relief that had been passed in 2002, the Jobs Creation and Workers Assistance Act, hereafter referred to as the 2002 law. The Jobs and Growth Tax Relief Reconciliation Act accelerated tax rate reductions on ordinary income; accelerated the provisions dealing with marriage penalty relief, the expansion of the 10 percent bracket, the child tax credit, reduced tax rates on capital gains and dividends; and increased business deductions.

State income tax receipts as a result of the Act are expected to increase by approximately \$23 million during the 2005 biennium. The provisions of the act are as follows:

- Reduce capital gains tax rates for long term gains to 15 percent and tax rates on dividends to 15 percent – this will increase state income tax collections as state taxpayers claim less federal taxes deductible.
- Accelerate federal tax rate reductions – instead of phasing-in the reduction in federal tax rates over many years, as the 2002 federal law required, the rates that would have been in effect in tax year 2006 will apply to tax year 2003. This will increase state income tax collections as state taxpayers claim less federal taxes deductible.
- Expansion of 10 percent bracket – under the 2002 federal tax changes, the expansion of the 10 percent bracket was to have taken place in tax year 2008. The Act implements this expansion beginning in tax year 2003. However, this provision ends beginning in tax year 2005 and the prior phase-in will resume. This will increase state income tax collections.
- Marriage penalty relief – under the 2002 federal tax changes, marriage penalty relief was to be phased-in with full phase-in taking place in tax year 2009. Under the Act, the 2009 relief is available in tax years 2003 and 2004. In tax year 2005, the relief reverts to the 2002 law phase-in amounts. This will increase state income tax collections.
- Expansion of the child tax credit – under the 2002 federal tax changes, the child tax credit was to be phased-in until it was \$1,000 in tax year 2010. The Act raises the child tax credit to \$1,000 in tax years 2003 and 2004, after which it reverts to the 2002 law phase-in amounts. This will increase state income tax collections.
- Alternative minimum tax exemptions – the Act temporarily raises the exemption amount in tax years 2003 and 2004, after which the exemption amounts revert to their previous level. This will increase state income tax collections.
- Increase deduction amounts for code 179 expensing – this raises the amount that can be expensed in one year to \$100,000 from the current amount \$25,000, for tax years 2003 through 2005. Because the state income tax system follows federal tax rules regarding expensing, this provision will decrease state tax revenues.

- Increase bonus depreciation to 50 percent in first year of life of equipment for equipment purchased between May 1, 2003 and January 1, 2005 - the 2002 law allowed a 30 percent bonus depreciation in the first year after purchase. This provision will decrease state tax revenues.

## **DISBURSEMENT ISSUES FOR THE 2005 BIENNIUM**

### **Children's Health Insurance Program (CHIP) – (\$0.6 million)**

In November 2003, the Governor approved the use of \$609,000 general fund to eliminate the waiting list for CHIP. These excess funds were available because the FMAP rate increase included in the Jobs and Growth Tax Relief Reconciliation Act can be used to replace general fund expenditures. However, use of the general fund for CHIP decreases the amount of general fund reversions.

### **Supplemental Appropriations**

#### ***District Court Assumption*** – (\$4.8 million)

The Judiciary's District Court Assumption Program is currently expending at a rate significantly above the 2005 biennium appropriation. At current levels of expenditure and without further mitigation efforts or other slowdowns in the rate of expenditure, the Judiciary could exceed its appropriation by as much as \$4.8 million to \$6.8 million over the biennium.

#### ***Public Schools*** – (\$7.9 million)

The expected general fund supplemental for the K-12 distribution program is \$7.9 million during the 2005 biennium. The supplemental appropriation is the result of higher costs in fiscal 2004 and 2005, and an expected shortfall in interest and income revenue from school trust lands in each year of the 2005 biennium.

Revenue Shortfall - Income (state special revenue) from common school trust lands is increasing due to higher natural resource prices, particularly oil and natural gas. However, the increase is mitigated due to lower than anticipated coal prices for a net increase of \$1.1 million over the biennium. The increase in mineral royalty revenue is more than offset by a reduction in investment earnings from the permanent trust balance. Even though fiscal 2004 earnings were anticipated to increase from fiscal 2003, the first eight months of fiscal 2004 are nearly the same as the comparable period of fiscal 2003. If earnings continue at the current pace, revenues will be reduced \$3.2 million over the biennium. Because general fund covers any shortfall in state special revenue from school trust lands to maintain total state funding at the statutorily required level, the reduction in state special revenue increases general fund expenditures by the same amount or an estimated net \$2.1 million for the 2005 biennium.

Cost Overruns - Data from school district budgets for fiscal 2004 indicate that fiscal 2004 general fund costs for direct state aid and guaranteed tax base (GTB) will exceed estimates by around \$3.0 million. The reason for this increase is probably due to less fund balance carryover from fiscal 2003 than anticipated. This is likely due to lower collections of property tax from Pennsylvania Power and Light (PPL), which protested its taxes, and from Northwestern, which did not pay a portion of their Spring 2003 taxes until Fall 2003. The enrollment count for October 2003, which forms the basis for the ANB count used in fiscal 2005, indicates that ANB in fiscal 2005 will be 1,000 students more than anticipated. As a result, general fund distribution costs are anticipated to be \$2.7 million higher than originally thought.

## ***Corrections***

At this time, cost overruns for the Department of Corrections are not expected in fiscal 2004. However, while fiscal 2004 expenditures should stay within the appropriation, there is cause for concern about expenditures in fiscal 2005. Upward trends in population, including currently higher than anticipated totals in more expensive destinations such as secure care, will put additional pressures on expenditures.

## ***Human Services***

At this time, a supplemental appropriation is not expected for Public Health and Human Services. Nonetheless, there are two primary areas of concern: 1) the population at Montana State Hospital; and 2) the state's inability to meet the maintenance of effort to receive the federal mental health block grant. Both of these issues could evolve into a supplemental appropriation situation.

## **Statutory and Language Appropriations, and Non-budgeted Transfers - \$1.3 million**

**Statutory Appropriations** – Statutory appropriations for debt service and transactional costs associated with the issuance of tax revenue anticipation notes (TRANS) are reduced by \$1.2 million over the biennium because of a more favorable interest rate received for the fiscal 2004 issue and the even better rate expected in fiscal 2005. Although the issue sizes are larger, the lower than expected interest rates more than off-set the additional costs of larger issues. The additional \$815,173 received from the sale of the Bozeman Armory (see “All Other” revenue above), in accordance with House Bill 14 (1999 session), is transferred to the debt service fund and reduces general fund statutorily appropriated for debt service by the same amount over the biennium. Other changes include increases of \$839,000 in retirement appropriation and new appropriations for Department of Justice tobacco enforcement and Governor declared emergencies totaling \$44,000.

**Language Appropriations** – House Bill 2 (2003 session) authorizes two general fund language appropriations:

1. The Judiciary is appropriated for the 2005 biennium the amount of general fund reverted in the 2003 biennium. Originally estimated to be \$646,000, an updated estimate indicates an amount of \$1.024 million, an increase of \$378,000.
2. The Department of Administration is appropriated up to \$700,000 for the biennium to pay money to the Highway Patrol retirement fund instead of transferring the money as done in previous years. A portion of this appropriation is also being used by the Department of Justice to pay money to the retirement fund as required by HB 559 (2003 session) instead of transferring the money as originally anticipated (see “Transfers” below).

**Non-budgeted Transfers** – Transfers out of the general fund decrease by \$1.3 million due to the net result of five factors:

1. HB 226 passed by the 57<sup>th</sup> Legislature transfers 12.5 percent in fiscal 2004 and 25 percent in fiscal 2005 of US mineral royalty revenue deposited to the general fund to the counties where the mining or extraction occurred. Because higher natural resource prices result in additional general fund revenue from US mineral royalties, disbursements from the general fund also increase an estimated \$1.8 million;
2. the additional \$815,173 received from the sale of the Bozeman Armory (see “All Other” revenue above), in accordance with House Bill 14 (1999 session), is transferred from the general fund to the debt service fund (see “Statutory Appropriations” above);
3. \$700,000 of expected transfers to the Highway Patrol retirement fund are replaced with a language appropriation;

4. SB 336 passed by the 58<sup>th</sup> Legislature provided for an additional optional \$4.00 vehicle registration fee to be used for state parks, fishing access sites, and state owned facilities at Virginia City and Nevada City. The legislation requires the revenue, estimated to be \$3.2 million over the biennium, be deposited to the general fund and then transferred to Department of Fish, Wildlife and Parks' state special revenue account. For the 2005 biennium, the executive will not deposit the revenue to the general fund, but instead will deposit the revenue directly to the state special revenue account. Therefore, the transfer of \$3.1 million out of the general fund will not occur; and
5. Various transfers that rely on vehicle count estimates decrease by \$129,000.

## **Other Adjustments**

### ***FMAP Change*** – (\$5.0 million)

DPHHS estimates of changes in general fund savings due to the change in FMAP were adjusted for a number of factors:

- An increase in fiscal 2003 of \$2.2 million and a reduction in fiscal 2004 of \$2.8 million to account for the change in reimbursement from a date of service to a date of payment methodology. This accounting change was implemented by the department to comply with federal Medicaid requirements. The federal reimbursement for Medicaid claims is based upon the date the claim is paid
- A reduction of \$1.5 million to adjust estimates for costs that are reimbursed entirely by the federal government rather than based upon the FMAP, and institutional costs reimbursements that are deposited to the general fund
- The decision by the executive to utilize \$2.3 million in savings for the Child Support Enforcement Division, and \$1.0 million for the Developmental Services Division for various expenses. While department estimates still include the DSD provision, department staff indicated in an email to LFD staff that these funds would not be allocated to the division<sup>1</sup>

The total adjustments of \$5.0 million differ slightly from the previously stated reduction of \$4.980 million due to additional information received on March 10.

### ***Fiscal 2003 Fund Balance Adjustment*** - \$1.3 million

The official audited Comprehensive Annual Financial Report general fund ending balance for fiscal 2003 is \$1.3 million greater than estimated. The largest changes are: 1) the reclassification of \$1.0 million transferred from the orphan share account to prior year activity (it had been classified as current year activity and shown as an increase to "All Other" revenue); and 2) \$0.4 million of cash not recorded on SABHRS in fiscal year 2001. The net change for errors, miscellaneous adjustments, and changes in inventories is negligible.

## **Summary**

Table 3 is a summarization of the LFD adjustments to the 2005 biennium general fund budget as adopted by the 58<sup>th</sup> Legislature. Items 1 through 5 shown in the table were discussed in a previous report issued in October 2003. Items 6 through 14 reflect adjustments that have been previously discussed in this report.

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<sup>1</sup> Email from Gail Briese-Zimmer to Pat Gervais on March 8.

<b>Table 3</b> <b>2005 Biennium General Fund Budget</b> <b>LFD Adjustments (In Millions)</b>	
Budgetary Item	2005 Biennium
Previously Addressed in October:	
1 Unanticipated Fiscal 2003 Balance	\$29.883
2 Federal Relief FMAP Increase *	19.029
3 US Mineral Royalty Transfer	(4.674)
4 Continuing Appropriations	(2.086)
5 Debt Service	1.411
Updated Information Since October	
6 Revenue Estimate Adjustments	(35.403)
7 Childrens Health Insurance Program	(0.609)
8 Public Schools Supplemental	(7.868)
9 District Court Assumption	(4.821)
10 Statutory Appropriations	1.023
11 Language Appropriations	(1.078)
12 Non-Budgeted Transfers	1.331
13 FMAP Change	(4.980)
14 Fiscal 2003 Fund Balance Adjustment	<u>1.335</u>
Total Adjustments	<b>(7.507)</b>
Anticipated Ending Fund Balance	<u>46.218</u>
<b>Revised Ending Fund Balance</b>	<b>\$38.711</b>
* Adjusted for FMAP Increase included in fiscal 2003 ending fund balance	

As shown in Table 3, total adjustments amount to a negative \$7.5 million. With these adjustments, the 2005 biennium general fund ending balance is projected to be \$38.7 million as compared to \$46.2 million anticipated by the legislature.

It should be noted that neither the \$50 million in federal Jobs and Growth Tax Relief Reconciliation Act monies nor the wildfire suppression costs are included in this table. This is because these funds are deposited in a federal account and the wildfire costs are paid from this federal account. The next section of the report combines the federal grant monies with the general fund to provide a complete financial picture.

## 2005 BIENNIUM GENERAL FUND BALANCE SHEET

Table 4 shows the revised 2005 biennium estimated ending fund balance for the general fund account. The projected general fund ending fund balance for the 2005 biennium of \$38.7 million is \$7.5 million less than the amount estimated at the end of the 58th legislative session. This balance incorporates actual revenue and disbursement data for fiscal 2003 and includes revenue and disbursement estimates for the 2005 biennium as budgeted by the 58th Legislature. Also included in this balance are adjustments that have been discussed in this report.

<b>Table 4</b> <b>2005 Biennium General Fund Balance</b> <b>Action By the 58th Legislature With Fiscal 2004 &amp; 2005 Adjustments</b> <b>In Millions</b>				
	Actual Fiscal 2002	Actual Fiscal 2003	Actual 2003 Biennium	Estimated 2005 Biennium
<b>Beginning Fund Balance</b>	<b>\$172.897</b>	<b>\$81.316</b>	<b>\$172.897</b>	<b>\$43.065</b>
<b>Revenues</b>				
Current Law Revenue	1,265.713	1,246.381	2,512.094	2,502.496
Legislation Impacts	0.000	0.000	0.000	107.996
Residual Transfers	0.000	0.000	0.000	0.000
<b>Total Revenue</b>	<b>\$1,265.713</b>	<b>\$1,246.381</b>	<b>\$2,512.094</b>	<b>\$2,610.492</b>
<b>Total Funds Available</b>	<b>\$1,438.610</b>	<b>\$1,327.697</b>	<b>\$2,684.991</b>	<b>\$2,653.557</b>
<b>Disbursements</b>				
General Appropriations	1,120.576	1,082.513	2,203.089	2,319.761
Statutory Appropriations	149.108	132.347	281.455	257.334
Local Assistance Appropriations	0.000	0.000	0.000	0.000
Miscellaneous Appropriations	68.016	84.423	152.439	6.350
Language Appropriations	0.000	0.000	0.000	1.245
Non-Budgeted Transfers	18.768	3.150	21.918	29.834
Continuing Appropriations	2.611	3.368	5.979	2.086
Supplemental Appropriations	0.000	0.000	0.000	13.168
Wildfire Costs	0.000	0.000	0.000	0.000
Feed Bill Appropriations	0.000	0.000	0.000	6.699
Anticipated FMAP Reversions				(13.440)
Anticipated Reversions	(3.176)	(29.974)	(33.150)	(8.191)
<b>Total Disbursements</b>	<b>\$1,355.903</b>	<b>\$1,275.827</b>	<b>\$2,631.730</b>	<b>\$2,614.846</b>
<b>Adjustments</b>	<b>(1.391)</b>	<b>(8.805)</b>	<b>(10.196)</b>	<b>0.000</b>
<b>Unreserved Ending Fund Balance</b>	<b><u>\$81.316</u></b>	<b><u>\$43.065</u></b>	<b><u>\$43.065</u></b>	<b><u>\$38.711</u></b>
<b>Federal Grant Monies</b>				
Federal Relief Grant Funds		25.000	25.000	25.000
State Net WildFire Costs			0.000	(38.792)
Governor's Spending Proposal			0.000	(11.064)
<b>Unreserved Ending Fund Balance + Federal Grant Monies</b>		<b><u>\$68.065</u></b>	<b><u>\$68.065</u></b>	<b><u>\$38.855</u></b>

Shown at the bottom of Table 4 is the impact on state finances when the federal relief grant funds and the current net state wildfire costs are combined with the general fund account. Between net state wildfire costs (\$31.7 million fiscal 2004 and an estimated \$7.1 million fiscal 2005) and the Governor's spending proposal (\$11.1 million), only \$0.1 million remains of the federal Jobs and Growth Tax Relief Reconciliation Act funds. This explains why the balance increases from \$38.7 million to \$38.8 million. This distinction is necessary because the federal grant monies are deposited to a federal account and the current wildfire costs are being paid from this federal account.

Table 5 shows the state's financial condition when the general fund account is combined with federal grant funds. This table is categorized by "current known fiscal issues", "current estimated other fiscal issues", and "current unknown other fiscal issues". While the amounts for certain items in this table are exactly the same as in Tables 3 and 4, this table summarizes the financial information in a way that provides a clear perspective on the amounts that are known versus the amounts that are estimated or totally unknown. At the bottom of the table, the amount of a negative \$7.5 million is shown that represents an estimate of the fund balance below the legislative adopted amount of \$46.2 million.

Included in the calculation of the projected ending fund balance is the estimated state wildfire costs for the 2003 season from the Department of Natural Resources and Conservation. These cost estimates were as of March 2004. The projected balance also includes an estimate for 2004 state wildfire costs based on a five-year average over the period 1998 through 2002.

## Other Fiscal Issues to Watch

### *Other Potential Supplementals*

As previously discussed, a supplemental appropriation is anticipated for public school support and district court assumption. The combined total for these supplemental appropriations is \$13.2 million. Other supplemental appropriations may be necessary for the Departments of Corrections and Public Health and Human Services and for the law enforcement academy (See “2005 Biennium Budget Spending “Pressure Points””). Our office will continue to monitor expenditure patterns in these and other areas as the fiscal year progresses.

### *School Funding Lawsuit*

In late January, a three-week trial in district court was convened to litigate the funding adequacy and equity of the educational system in Montana. The suit, brought by the Montana Quality Education Coalition and other plaintiffs, alleges the State has not adequately funded schools in Montana to a level of quality required by the accreditation standards promulgated by the Board of Education and is in violation of the Constitution which requires the State to provide a “basic system of free quality public elementary and secondary schools”. The suit also alleges that disparities in taxpayer effort and spending per student across districts are excessive. Plaintiffs relied on a recent study performed for the Montana School Boards Association that indicated adequate resources for a “suitable education” in Montana would require additional statewide spending increase of \$170 million to \$350 million per year. The district judge will hear final arguments at the beginning of April. It is unknown when the final decision will be made, but it is likely that the case will be appealed by the plaintiff or defendant.

### *Video Gambling Surcharge Lawsuit*

House Bill 758 (2003 session) levied a surcharge on each video gambling machine based on the number of machines per establishment: 1) \$10 per machine for establishments with less than 20 machines; and 2) \$20 per machine for establishments with 20 machines. The conclusion of a lawsuit addressing this surcharge is currently pending that puts the \$513,420 estimated biennial general fund revenue at risk.

<b>Table 5</b> <b>General Fund Account Plus Federal Grant Funds (In Millions)</b> <b>Change in Fund Balance</b>	
Budgetary Item	2005 Biennium
<b>Budgeted Ending Fund Balance</b>	<b>\$46.218</b>
<u>Current Known Fiscal Issues</u>	
Federal Relief Grant Funds (Fed \$)	50.000
Federal Relief FMAP Increase *	19.029
Unanticipated Fiscal 2003 Balance	<u>29.883</u>
Sub Total	\$98.912
US Mineral Royalty Transfer	(4.674)
Continuing Appropriations	(2.086)
Debt Service	1.411
Childrens Health Insurance Program	(0.609)
Governor's Spending Proposal (Fed \$)	(11.064)
<u>Current Estimated Other Fiscal Issues</u>	
Revenue Estimate Adjustments	(35.403)
State Wildfire Costs 2003 Season (Net) (Fed \$)	(31.747)
State Wildfire Costs 2004 Season (Net) (Fed \$)	(7.045)
Public Schools Supplemental	(7.868)
District Court Assumption	(4.821)
Statutory Appropriations & Transfers	1.276
FMAP Change	(4.980)
Fiscal 2003 Fund Balance Adjustment	1.335
<u>Current Unknown Other Fiscal Issues</u>	
Other Potential Supplementals	
School Funding Lawsuit	
Surcharge Lawsuit	
Protested Property Taxes	
Potential Ending Fund Balance	\$38.855
Budgeted Ending Fund Balance	<u>46.218</u>
<b>Change In Fund Balance</b>	<b>(\$7.363)</b>
* Adjusted for FMAP Increase included in fiscal 2003 ending fund balance	



## ***Protested Property Taxes***

The state may be liable for the return of all or a portion of \$11.0 million in taxes paid in protest since 2000 if the state loses tax protest cases brought by several owners of centrally assessed property. SB 294, passed during the 2003 legislative session, allows the state to deposit in the general fund tax revenues protested by centrally assessed companies and use them for ongoing operations. In the past, these monies were held in escrow until the case was settled. In fiscal 2003, the state general fund received \$3.8 million in protested taxes, and it is expected that during the 2005 biennium an additional \$7.2 million will be received.

## **EXPENDITURE REDUCTIONS UNDER 17-7-140, MCA**

As previously explained, the general fund account may end the 2005 biennium with a balance of \$36.6 million or \$9.6 million less than anticipated by the 58<sup>th</sup> Legislature. It should be emphasized that this projected balance includes \$98.9 million (shown in Table 5) of additional funds that were not anticipated by the 58<sup>th</sup> Legislature. In other words, without these additional funds, the projected general fund balance at the end of the 2005 biennium would be a negative \$60.2 million.

Under Title 17-7-140, MCA, the Governor is required to “ensure that the expenditure of appropriations does not exceed available revenue”. If revenue projections worsen or 2005 biennium wildfire suppression costs or supplemental appropriations are greater than shown in Table 5, the executive may be required to implement expenditure reductions as outlined under 17-7-140, MCA. As stated in this section of law, “a "projected general fund budget deficit" means an amount, certified by the budget director to the governor, by which the projected ending general fund balance for the biennium is less than 2% of the general fund appropriations for the second fiscal year of the biennium.” Two percent of the general fund appropriations for the second year of the biennium would be approximately \$26 million. As amended by the last legislature, 17-7-140 (3i) reduces the trigger amount as the biennium nears the end. This phased-in reduction of the trigger begins in October 2004. The following is the applicable section of statute that addresses the roles and responsibilities of the executive, the Legislative Finance Committee, and the Revenue and Transportation Interim Committee (RTIC).

### *17-7-140.*

*Reduction in spending. (1) (a) As the chief budget officer of the state, the governor shall ensure that the expenditure of appropriations does not exceed available revenue. Except as provided in subsection (2), in the event of a projected general fund budget deficit, the governor, taking into account the criteria provided in subsection (1)(b), shall direct agencies to reduce spending in an amount that ensures that the projected ending general fund balance for the biennium will be at least 1% of all general fund appropriations during the biennium. An agency may not be required to reduce general fund spending for any program, as defined in each general appropriations act, by more than 10% during a biennium. Departments or agencies headed by elected officials or the board of regents may not be required to reduce general fund spending by a percentage greater than the percentage of general fund spending reductions required for the total of all other executive branch agencies. The legislature may exempt from a reduction an appropriation item within a program or may direct that the appropriation item may not be reduced by more than 10%.*

*(b) The governor shall direct agencies to manage their budgets in order to reduce general fund expenditures. Prior to directing agencies to reduce spending as provided in subsection (1)(a), the governor shall direct each agency to analyze the nature of each program that receives a general fund appropriation to determine whether the program is mandatory or permissive and to analyze the impact of the proposed reduction in spending on the purpose of the program. An agency shall submit its analysis to the office of budget and program planning and shall at the same time provide a copy of the analysis to the legislative fiscal analyst. The office of budget and program planning shall review each agency's analysis, and the budget director shall submit to the governor a copy of the office of budget and program planning's recommendations for reductions in spending. The budget director shall provide a copy of the recommendations to the legislative fiscal analyst at the time that the recommendations are submitted to the governor and shall provide the legislative fiscal analyst with any proposed changes to the recommendations. The legislative finance committee shall meet within 20 days of the date that the proposed changes to the recommendations for reductions in spending are provided to the legislative fiscal analyst. The legislative fiscal analyst shall provide a copy of the legislative fiscal analyst's review of the*

*proposed reductions in spending to the budget director at least 5 days before the meeting of the legislative finance committee. The committee may make recommendations concerning the proposed reductions in spending. The governor shall consider each agency's analysis and the recommendations of the office of budget and program planning and the legislative finance committee in determining the agency's reduction in spending. Reductions in spending must be designed to have the least adverse impact on the provision of services determined to be most integral to the discharge of the agency's statutory responsibilities.*

*(2) Reductions in spending for the following may not be directed by the governor:*

- (a) payment of interest and principal on state debt;*
- (b) the legislative branch;*
- (c) the judicial branch;*
- (d) the school BASE funding program, including special education;*
- (e) salaries of elected officials during their terms of office; and*
- (f) the Montana school for the deaf and blind.*

*(3) (a) As used in this section, "projected general fund budget deficit" means an amount, certified by the budget director to the governor, by which the projected ending general fund balance for the biennium is less than:*

*(i) 2% of the general fund appropriations for the second fiscal year of the biennium prior to October of the year preceding a legislative session;*

*(ii) 3/4 of 1% in October of the year preceding a legislative session;*

*(iii) 1/2 of 1% in January of the year in which a legislative session is convened; and*

*(iv) 1/4 of 1% in March of the year in which a legislative session is convened.*

*(b) In determining the amount of the projected general fund budget deficit, the budget director shall take into account revenue, established levels of appropriation, anticipated supplemental appropriations for school equalization aid, and anticipated reversions.*

*(4) If the budget director determines that an amount of actual or projected receipts will result in an amount less than the amount projected to be received in the revenue estimate established pursuant to 5-5-227, the budget director shall notify the revenue and transportation interim committee of the estimated amount. Within 20 days of notification, the revenue and transportation interim committee shall provide the budget director with any recommendations concerning the amount. The budget director shall consider any recommendations of the revenue and transportation interim committee prior to certifying a projected general fund budget deficit to the governor.*

In summary, the projected ending fund balance for the general fund at the end of the 2005 biennium is \$38.7 million or \$12.7 million above the expenditure reduction trigger. This projected balance includes supplemental appropriations for public schools and district court assumption, but no supplemental appropriation for any other state agency. Because the projected ending balance is very close to the statutorily defined \$26 million trigger, small changes in expenditures or revenues in a negative direction may require the executive to implement the provisions of the "reduction in spending" statute delineated in 17-7-140, MCA.

## **SUMMARY**

Based on data through the end of February 2004, total general fund revenues are expected to be \$35.4 less than estimated by the 58<sup>th</sup> Legislature. While the outlook for some revenue categories has worsened since December, the overall general fund revenue picture has improved by about \$12 million since December. The sources with significant change from the December status report are corporation income tax, US mineral royalty revenue, and individual income tax.

Corporation income taxes are expected to be below expectations because of significant refund activity and the impacts of the accelerated depreciation legislation enacted at the federal level. Some refunds are due to the economic slowdown while others are due to carry back capital losses. Because of these refunds and the federal legislation impacts, it is nearly impossible to assess the underlying growth of corporate taxable income in Montana. Without information to establish a clear trend, corporation income taxes are assumed to remain relative constant throughout the biennium. Tax return data filed by May 15<sup>th</sup> could provide insight to future corporation tax trends for fiscal 2005 and beyond. If

corporate profits in Montana follow national trends, estimates from corporation income tax could be revised upward at a later date.

US mineral royalty revenue collections have exceeded expectations because of higher oil and gas prices and an apparent increase in coal production on federal lands. To assess trends for this source, commodity price and production information is imperative to develop a revised estimate. Because this information is maintained on a federal computer system that has had significant problems, the availability of timely and accurate data is difficult to obtain. As more detailed information is obtained from the federal Mineral Management Service, there is a high probability that the estimate from this source may be revised downward.

Total individual income tax collections before refunds have improved by almost two percentage points since November. Refunds, however, have increased by over eight percent when compared to December, January, and February of last year with the same period of this year. Since March, April, and May are typically the higher refund months, refund activity during these months will indicate whether collections will be consistent with current forecasts. More electronic filings plus the short turnaround time to process refunds may explain the current acceleration in refunds. If refunds continue to accelerate, the estimate from this source may be revised downward.

In addition to negative revenue adjustments of \$35.4 million, general fund supplemental appropriations for public schools and district court assumption are estimated to be \$12.7 million. Although supplemental appropriation needs are a concern in other areas of government, data is insufficient to prepare an accurate estimate at this time. The December status report also indicated the FMAP funds available would be \$19.0 million. Based on revised calculations by the Department of Public Health and Human Services, this amount has been revised downward by \$5.0 million.

State wildfire costs for the 2003 season have been revised upward to \$31.7 million. All of these costs are funded from the \$50 million grant monies Montana received under the federal Jobs and Growth Tax Relief Reconciliation Act. As previously mentioned in the report, state wildfire costs for the 2004 season are estimated at \$7.0 million which was based on a five-year average over the period 1998 through 2002. However, fire managers at the National Interagency Fire Center in Boise, Idaho are suggesting that drought, warm temperatures, and damaged vegetation are pointing to another difficult fire season through many parts of the West including the Rocky Mountain Region. The probability that the 2004 fire season will be greater than \$7.0 million is high.

Based on the major adjustments identified above, the general fund balance is expected to be \$38.7 million by the end of the 2005 biennium or \$7.5 million less than anticipated by the 58<sup>th</sup> Legislature. This projected balance does not include any of the \$50 million grant monies Montana received under the federal Jobs and Growth Tax Relief Reconciliation Act. The grant monies have been allocated as follows:

1. \$31.7 million state wildfire costs 2003 season;
2. \$11.1 million Governor's spending proposal;
3. \$ 7.2 million unallocated.